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BEFORE THE INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA

In the Matter of the Rate Application of	)	
MERCURY CASUALTY COMPANY,	)	FILE NO. PA03029457
Applicant.	)	

RULING ON MERCURY CASUALTY COMPANY'S JURISDICTIONAL CHALLENGE

The parties are hereby informed that, based on a review of the pleadings in this case, the oral and written arguments submitted by counsel and the applicable law, the administrative law judge finds that the California Insurance Commissioner has jurisdiction over the subject matter set forth in the California Department of Insurance's Notice of Hearing, specifically, Mercury's Casualty Company's rate application (CDI Rate Filing Bureau App. No. 03-1661) that includes a rule change to restrict eligibility for its homeowners' insurance. Mercury Casualty Company's jurisdictional challenge in this matter IS REJECTED.

Procedural Background

Pursuant to California Insurance Code §1861.05(c) and California Code of Regulations, title 10, §2648.3, the Insurance Commissioner declined to approve Mercury Casualty Company's ("Mercury") rate application [1]("Application") pertaining to its homeowners' program and determined, instead, to hold a hearing on the Application. Accordingly, counsel for the California Department of Insurance ("CDI") filed and served a Notice of Hearing on May 12, 2003, and Mercury filed and served its Notice of Defense on May 27, 2003.

At issue is Mercury's proposed manual rule change to its homeowners' program rather than a proposed rate increase. The proposed underwriting rule change involves a "tying arrangement" and states as follows:

> "Mercury Casualty Company will no longer offer homeowners insurance to the general public. We will only consider applications from automobile policyholders in the Mercury group of companies."

Mercury's Notice of Defense alleged that: (1) its rate application met all the requirements of California Insurance Code §1861.05; (2) the Commissioner was improperly exercising his rate authority; and (3) the Commissioner was acting in excess of his jurisdiction by withholding approval of Mercury's application.

A scheduling conference was held on June 24, 2003, at 1:30 p.m. before Administrative Law Judge Marjorie A. Rasmussen in the Administrative Hearing Bureau's conference room located at 45 Fremont Street, 22nd floor, San Francisco, California. Ms. Mary Ann Shulman, Esq. and Mr. Antonio Celaya, Esq. appeared on behalf of the CDI. Mr. Douglas L. Hallett, Esq., Mr. Joseph B. Miller, Esq. and Mr.

Marc J. Levine, Esq. appeared on behalf of Mercury via telephone conference call. During the scheduling conference, counsel for Mercury raised a jurisdictional challenge to the proceedings. Following arguments by counsel, Judge Rasmussen ordered that written briefs be submitted on the jurisdictional issue. Pursuant to a stipulation and deemer waiver signed by counsel, Judge Rasmussen also ordered that the 180 day deemer period for commencing the evidentiary hearing in this proceeding be continued to December 1, 2003, or to a date to be agreed upon after the final ruling on the jurisdictional issue.

Contentions

Mercury

Mercury contends that its proposed underwriting guideline is not a "rate," does not impact its rate, does not violate anti trust laws and is not discriminatory.[2] Furthermore, Mercury claims that the proposed "tying arrangement" is akin to a multiple policy discount that has already been approved by the Commissioner as a permissible eligibility guideline. Mercury concludes that, since the Insurance Commissioner lacks subject jurisdiction over the matters contained in the CDI's Notice of Hearing, the Commissioner should vacate the hearing in this proceeding and approve Mercury's

[1] Mercury Exhibit 26. The Application was received by the CDI on February 28, 2003, and is identified as follows: CDI Rate Filing Bureau App. No. 03-1661 - Applicant File No. CA-MCC-HO-0301.

[2] Mercury filed a Complaint for Declaratory Relief (*Mercury Insurance Company v. Harry Low, Insurance Commissioner*, San Francisco Superior Court, Case No 413076) in which it alleged that the Commissioner refused to review Mercury's prior rate filing until Mercury removed a tying arrangement that is similar to the one now before the Commissioner in this administrative proceeding. The CDI's demurrer to the first amended complaint was sustained without leave to amend on the grounds that Mercury failed to exhaust its administrative remedies. Mercury's appeal of this decision (*Mercury Insurance Company v. Harry Low, Insurance Commissioner*, First Appellate Court Case No. A 102532) alleges that the Superior Court applied the exhaustion of administrative remedies doctrine without holding the Commissioner to any burden to establish his ratemaking jurisdiction over the tying arrangement in dispute. Mercury asserts the same argument in support of its jurisdictional challenge in this proceeding.

Application "forthwith."[3] Alternatively, Mercury claims that if it is required to justify its tying arrangement in ratemaking terms, there is clear actuarial support for its marketing plan.[4]

CDI

The CDI contends that the Insurance Commissioner has extensive powers over rate regulation and that the courts recognize the commissioner's expertise in evaluating and resolving issues regarding both actuarial risks and underwriting practices. According to the CDI, Mercury's tying arrangement is clearly a rate issue and the Commissioner has jurisdiction to review the tying arrangement pursuant to Insurance Code §1861.05.

Specifically, the CDI argues that the tying arrangement raises the issues of (1) whether the eligibility restriction meets the rate setting and underwriting standards of various provisions of the Insurance Code and implementing regulations and (2) whether the eligibility restriction impedes an eligible consumer from purchasing a good driver discount policy from the insurer of his or her choice in violation Insurance Code §1861.02. Contrary to Mercury's assertions, the CDI claims that the "tying arrangement" is not like a multiple policy discount because it is not voluntary. The CDI contends that Mercury's tying arrangement does not bear "a substantial relationship to the risk of loss."[5]

[3] Mercury's Opening Brief, p. 11.
[4] Mercury's Opening Brief, p. 21.
[5] CDI's Brief, pp. 2-3.

Discussion

Overview of Proposition 103: Insurance Code §1861.05(a)

The statutes enacted through Proposition 103[6], an initiative supported by a majority of voters in 1988, establish the system for the prior approval of insurance rates. Section 1861.05(a) provides:

> "No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. In considering whether a rate is excessive, inadequate or unfairly discriminatory, no consideration shall be given to the degree of competition and the commissioner shall consider whether the rate mathematically reflects the insurance company's investment income."

The language in the first sentence "echoes similar language in the law of most states, as well as former section 1852 which it replaces." (*Calfarm Insurance Co. v. Deukmejian* (1989) 48 Cal.3d 805, 822.) However, the requirement of prior approval of rates marked a significant change in California law and the provision regarding investment income is unique. The declared purpose of Proposition 103 is "to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." (Historical and Statutory Notes, 42A West's Ann. Ins. Code (1993 ed.) §1861.01, p. 649. *See also*, *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 813.) As stated by the California Supreme Court: "If nothing else is clear, this is: Proposition 103 was intended to do away with the 'open competition' system. . . ." (*20th Century Ins. Co. v. Garamendi*, (1994) 8 Cal.4th 216, 300.)

[6] Proposition 103 is codified at Insurance Code §1861.01 *et seq.* All references to sections are to the Insurance Code unless otherwise indicated.

The Insurance Commissioner has been charged with the responsibility of protecting consumers from arbitrary insurance ***rates and practices***, and ensuring that insurance is ***fair, available and affordable*** within a ***competitive market***. Mercury's argument that the Commissioner has no jurisdiction to review Mercury's rate filing because it does not seek to change its rates but requests a proposed underwriting guideline limiting the sale of a Mercury's homeowners' policy to its automobile policyholders is not persuasive in light of the clear mandate of Proposition 103 and the court decisions that have deferred to the Commissioner's expertise in this area.

The Insurance Commissioner Has Jurisdiction Over the Subject Matter Of Mercury's Rate Application In This Case

The California Supreme Court recognizes the Insurance Commissioner's "broad discretionary powers in rate regulation to adopt rules and regulations necessary to promote the public welfare" and that he "may exercise such additional powers as are necessary for the due and efficient administration of powers expressly granted by statute, or as may fairly be implied from the statute granting the powers." (*CalFarm Insurance Co. v. Deukmejian, supra,* 48 Cal. 3d at p. 824). Courts also have deferred to the Commissioner's expertise in evaluating and resolving issues concerning actuarial risks and unfairly discriminatory underwriting practices. (*Wilson v. Fair Employment and Housing Commission* (1996) 46 Cal. App.4th 1213.)

While Mercury's rate filing at issue here does not seek a specific rate increase, both parties concede that underwriting guidelines such as Mercury's proposed "tying arrangement" may impact an insurer's pool of risk which, in turn, may impact its loss development and ultimately its rates.[7] Mercury argues, however, that an insurer does not

[7] Mercury Reply Brief, pp. 9-10; CDI Brief, p. 10.

need to obtain approval "for every step it takes to change its pool of risks."[8] The CDI counters that if Mercury's tying arrangement does, indeed, bear a substantial relationship to the risk of loss, then "it should be quantified and reflected in Mercury's rate."[9]

Based on the record, the CDI's arguments are more persuasive on this issue because the proposed underwriting rule appears to have a close connection to Mercury's risk pool and ultimately its loss development and rates. Mercury's claim that its tying arrangement is akin to a multi-policy discount is not persuasive based on the record because the former program is mandatory while the latter is voluntary in that the consumer may elect to purchase more than one policy with Mercury to qualify for the discount.

Since case law clearly supports the Commissioner's jurisdiction over ratemaking issues, Mercury's rates, which were previously approved without the disputed underwriting guidelines, need to be reviewed again in conjunction with Mercury's proposed tying arrangement to ensure that the rates are not excessive, inadequate, unfairly discriminatory *or* ***otherwise in violation of Chapter 9 of the Insurance Code.*** (Insurance Code §1861.05.)

Mercury's argument that its underwriting rule cannot be reviewed in a prior approval context because it is not a "rate" also is not convincing in light of the provisions of Chapter 9 of the Insurance Code which apply, not only to rates, but to rating plans, systems and underwriting rules. It makes no sense to deny the Commissioner jurisdiction to review Mercury's rate filing in a prior approval context when the Commissioner clearly would have jurisdiction to review Mercury's underwriting rules if a consumer

[8] Mercury Reply Brief. p. 9.
[9] CDI Brief, p. 9.

filed a complaint with the CDI pursuant to Insurance Code §1858 and a non-compliance hearing proceeding was commenced.[10] The initial test of whether an insurer's underwriting rule impacts rates need not be in a non-compliance hearing that carries the risk of penalties. Likewise, the public policy behind Proposition 103 would not be fully served if consumers were first required to file a complaint alleging a harm before the Commissioner could review the rate impact of an insurer's underwriting rule.

Accordingly, based on the record and applicable law, Mercury's jurisdictional challenge IS REJECTED.

DATED: September 22, 2003

/s/
MARJORIE A. RASMUSSEN
Administrative Law Judge
Department of Insurance

[10] Insurance Code §1858 states, in pertinent part, as follows: "(a) Any person aggrieved by any rate charged, rating plan, rating system or underwriting rule followed or adopted by an insurer or rating organization may file a written complaint with the commissioner requesting that the commissioner review the manner in which the rate, plan, system or rule has bee applied with respect to the insurance afforded to that person. In addition the aggrieved person may file a written request for a public hearing before the commissioner, specifying the grounds relied upon."